United States Court of Appeals

for the Second Circuit

AMICUS BRIEF

75-1004

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FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Appellee,

v.

ANTHONY M. NATELLI and JOSEPH SCANSAROLI,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF ON BEHALF OF PEAT, MARWICK, MITCHELL & CO., *AMICUS CURIAE*, IN SUPPORT OF PETITION FOR REHEARING AND SUGGESTION OF REHEARING *IN BANC*

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August 11, 1975

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We urge two points which we believe are of critical significance when criminality is ascribed to professional judgments.

1. The footnote to NSMC's 1968 financial statements in its 1969 proxy statement did not disclose that sales and earnings reflected in the financial statements issued by NSMC in 1968 with PMM's report had been later written off or the counterbalancing fact that the reversal of a 1968 tax reserve reduced the net income impact of the write-off to the insignificant amount of $21,000. Appellants never contended that the judgment of non-disclosure was "inadvertent" (Slip Op. p. 5178),* but it was a judgment.

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* Mr. Natelli was the responsible audit partner and has always accepted responsibility for the judgment which he made.

As the Court's opinion suggests, this judgment might have been made so as to conceal previous errors (Slip Op. p. 5178). As the record shows, it might have been made because in all the circumstances the disclosure was honestly believed to be of little significance to an investor's perception of the present situation of what had become a radically different company.

The crucial question then was whether "materiality", in a criminal prosecution which alleges the knowing misstatement of a material fact, is only an objective question or whether there is also a second question for the jury of whether the defendant professional honestly, if mistakenly, believed that the fact was immaterial.

The Court decided that only the first question need be put to the jury; the Court cited *United States* v. *Simon*, 425 Fed.2d 796, 806 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970). (Slip Op. p. 5178).

We submit that the cited language in *Simon* related only to whether expert testimony of objective non-materiality need be given conclusive effect, a question which the Court in *Simon* answered in the negative. But the issue here is different. It is one of *mens rea*, of culpability, of criminal knowledge—not the preliminary question of whether a statement or omission is or is not material.

In *Simon*, Judge Mansfield instructed the jury to consider "whether [the accountants] acted in good faith and on the mistaken assumption that netting might be a possibility." (*Simon* Tr. p. 4028). No such instruction was given here, and the Court's decision stands for the proposition that no such instruction need ever be given.*

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* The Court states (Slip Op. p. 5179) that a subjective test was also charged. With respect, we submit that the District Court's detailed charge (Tr. 2368-70) concerning objective materiality could not have been understood by the jury in a subjective sense

Beyond what we submit is the necessary intendment of a criminal provision which is addressed to a "willful and knowing" misstatement of material fact,* we submit that the Act under which the indictment was drawn requires that the question of subjective knowledge of materiality be clearly put to the jury. Rule 3-02 of the Commission's Regulation S-X, which governs financial statement presentation, provides that an amount "need not be separately set forth" if it is "not material", and Section 23(a) of the Securities Exchange Act of 1934 provides that liability may not be imposed under the Act for any act "done or omitted in good faith in conformity with any rule or regulation of the Commission. . . ."

2. The unaudited nine-months financial statements for NSMC reflected the sales, costs and income attributable to the Eastern commitment to utilize NSMC services. The Court held that the commitment was suspicious, produced under suspicious circumstances and known to be suspicious by the accountant who was "associated" ** with the statements (Slip Op. p. 5181).

Accepting *arguendo* the evidentiary weight that the Court perceived, we submit that the Court, while disclaim-

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by reason of the language the Court quotes. In any event, the Court's opinion will be understood to stand for the proposition that in criminal prosecutions "Materiality is an objective matter. . . ." (Slip Op. p. 5179). Put another way, if the defendant is objectively mistaken, he is necessarily criminally mistaken.

* Section 2.02(4) of the A.L.I. Model Penal Code (1961) provides:

> "When the law defining an offense prescribes the kind of culpability that is sufficient for the commission of an offense, without distinguishing among the material elements thereof, such provision shall apply to all the material elements of the offense, unless a contrary purpose plainly appears."

** The concept of "association" with unaudited financial statements has been developed by the accounting profession and applies when audited financials appear in the same document.

ing the result (Slip Op. p. 5188), has created a new standard for professionals, although an issue of professional conduct which was necessarily involved was not adequately explicated to the jury. The Court cited views of the accounting profession expressed in a 1972 Statement (Slip Op. pp. 5180-1, 5188) to establish a professional duty, but it nevertheless—and inconsistently—concluded that the question was one for the "common understanding" of lay jurors (Slip Op. p. 5188).

It must be so, we submit, that, if a professional's obligations are in some measure established by his profession, they are equally in some measure qualified by the conventions of his profession—here that independent verification of figures in unaudited statements is not required.* We do not contend that compliance with professional convention is a conclusive defense, which was the issue in *Simon*. We contend rather that the jury should have been instructed concerning the distinction between the accountant's role with respect to audited and unaudited figures so that it might meaningfully assess his state of mind in the context of the things he habitually does or does not do in these different situations.

The Court disposed of the absence of this instruction on the basis that there was a "deviation" which the lay jury could assess without such guidance (Slip Op. p. 5188). But by hypothesis criminal cases against professionals will always present what appear to the prosecutor and the grand jury to be professional deviations. Thus, the Court's opinion stands for the "Catch 22" proposition that the jury

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* As Judge McLean held in a landmark civil case:

"Accountants should not be held to a standard higher than that recognized in their profession." *Escott* v. *BarChrist Construction Corp.*, 283 F.Supp. 643, 703 (S.D.N.Y. 1968).

need not be instructed concerning differing professional obligations precisely when a professional's defense in a criminal case is predicated upon his belief as to the limitations upon the steps professionally required of him in the circumstances.

CONCLUSION

We respectfully submit that this Court should grant rehearing and we respectfully suggest that rehearing *in banc* is appropriate.

Dated: New York, New York
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Respectfully submitted,

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